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IN THE

Supreme Court of the United States

October Term, 1946.

No. 1014.

Ethel S. Garrett and George A. Garrett, *Petitioners*,

v.

District of Columbia, *Respondent*.

PETITION FOR WRIT OF CERTIORARI TO THE COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA, AND BRIEF IN SUPPORT THEREOF.

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PETITION FOR WRIT OF CERTIORARI TO THE COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA.

To the Honorable, the Chief Justice and the Associate Justices:

Petitioners, Ethel S. Garrett and George A. Garrett, respectfully pray that a writ of certiorari be issued to review the judgment of the United States Court of Appeals for the District of Columbia entered in this cause December 23, 1946, at its number 9275 and 9276, affirming decisions of the Board of Tax Appeals for the District of Columbia (R. 13). Petition for rehearing was denied January 17, 1947. (R. 14.) The opinion of the Court of Appeals appears in the record herein (R. 11-12), and is not yet reported.

I. The Matter Involved.

This case involves a peculiar and unique provision of the income tax law enacted by Congress for the District of Columbia. It is an enactment which taxes capital gains on the sale of property which has been held two years or less, yet imposes no tax whatever if the property has been held for longer than two years.

No other income tax law has a provision even remotely comparable in operation and effect. Many do impose a less burdensome tax if the property sold has been held for a prescribed period, in order to promote realization of gain and increase revenue. The unique feature of the enactment here in question is that it fails to impose any tax at all on gains realized after the prescribed holding period, yet allows full deduction within the period from all income otherwise taxable of losses from sales. The result is that usually losses are realized within the period and gains are not, thus working injury to the revenue both directly and indirectly, with no compensating advantage whatever.

The contention is that this enactment is irrational, that it works an arbitrary, unreasonable and capricious discrimination, without material difference, and that it is, therefore, invalid within the rule of *Heiner* v. *Donnan, infra.*

Statement of the case.

Petitioners, individuals trading on their own account, made during 1944 gains from sales of stocks and bonds which they had held for less than two years. They reported the transactions in their income tax returns to the District of Columbia, but did not include the gains in taxable income on the ground, set forth in letters attached to the returns, that the sales were of capital assets not subject to tax by sec. 6(a) of the statute, 53 Stat. 1091, sec. 47-1506(a) D. C. Code 1940, and that the provision of said section which purports to limit exclusion from tax to such property only if held for more than two years in invalid. (R. 4-5, 9.)

Petitioners are residents of the District of Columbia, and the sales in question were made on the New York Stock Exchange in the State of New York. In some instances orders therefor were given and securities delivered at the brokers' offices in the District of Columbia, and thence transmitted to New York for execution; in other instances orders were given and securities delivered at the brokers' offices in New York. (R. 4-5, 9.)

Additional income tax was assessed and collected from petitioners upon said gains by the District of Columbia; petitioners appealed to the Board of Tax Appeals for the District of Columbia, which affirmed the assessments, and review was then taken to the Court of Appeals for the District of Columbia, which likewise affirmed. (R. 5, 7-8, 9, 13.)

The statute involved.

The statute involved reads:

> "*Gains or Losses from Sale of Assets.—*
>
> "(a) No gain or loss from the sale or exchange of a capital asset shall be recognized in the computation of net income under this chapter. For the purposes of this chapter, 'capital assets' means property held by the taxpayer *for more than two years* (whether or not connected with his trade or business) but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of a taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.
>
> "(b) Gains or losses from the sale or exchange of property other than a capital asset shall be treated in the same manner as other income or deductible losses, and the basis for computing such gain or loss shall be the cost of such property or, if acquired by some means other than purchase, the fair market value thereof at the date of acquisition."

Sec. 6, District of Columbia Revenue Act of 1939, c. 367, title II (53 Stat. 1091), sec. 47-1506, D. C. Code 1940. (Italics added.)

It is the language of the statute italicised above, namely *"for more than two years"*, which petitioners contend is an invalid and a separable enactment.

II. Jurisdiction.

Review of this case is invoked under sec. 240(a) of the Judicial Code as amended, and under sec. 4(a) of the Act of Congress of Aug. 17, 1937, c. 690, title IX (50 Stat. 673), as added by Act of May 16, 1938, c. 223, sec. 8 (52 Stat. 371), sec. 47-2404 D. C. Code 1940, and the Act of July 26, 1939, c. 367, title II, sec. 31 (53 Stat. 1101), sec. 47-1531 D. C. Code 1940.

The provisions cited from the District of Columbia Code specifically authorize certiorari in cases such as this.

III. Question Presented.

May Congress, enacting an income tax to provide revenue for the District of Columbia, validly impose no tax at all upon gains from sales of property (other than stock in trade, inventory-able property, and property held for sale to customers) if held by the seller for more than two years, but impose tax thereon notwithstanding if held by the seller for a shorter time?

Otherwise stated: May an income tax for the District of Columbia be validly imposed upon the sole basis of the period of time during which property is held, excluding from tax property held for a longer period of time? For example, A and B each acquire the same number of shares of stock of the same corporation at identical cost, but A acquires his one day earlier than B. Two years after B acquired his stock, both sell at the same price and realize identical gains. B's gain is taxed, A's gain is not. The property of each is the same, the nature of the tenure of each

is the same, the gain of each is identical in amount, each has sold (taxable event) at the same time; only the period of time the property was held differs. Is the tax validly imposed upon that single circumstance?

IV. Reasons for Allowance of the Writ.

The statute involved uses a holding period as the basis to determine whether there shall be any tax or none. In all other income tax legislation, Congress has used that distinction merely to determine what the proportion or amount of the tax shall be. Cf. Internal Revenue Code, sec. 117, 53 Stat. 51. The federal revenue acts from 1921 to 1932, inclusive, defined capital assets in terms superficially similar to the definition thereof in the District of Columbia statute, in that they included a two year holding provision as does it. The effect, however, in those acts was radically different, for by them all gains were taxed, the period held having relation only to the size of the tax imposed.

This statute reaches its result by way of definition of the term "capital assets", after first providing that gains from their sale shall not be taxed. The consequence of the definition is in effect to say that a capital asset is not a capital asset until it is two years old. This is contrary to fact and arbitrary, because neither the nature of the tenure or the character of the property is affected by the passage of the time prescribed. This passage of time, which is the sole basis of the distinction attempted to be drawn, has no logical or relevant effect to cause the drastic consequence, namely tax vel non.

It is contended that this works an unreasonable discrimination, in violation of the Fifth Amendment of the Constitution, between taxpayers similarly circumstanced in every material particular, without difference of substance, and that the distinction drawn is contrary to fact. *Heiner* v. *Donnan,* 285 U. S. 312, 52 S. Ct. 358, 76 L. Ed. 772; *Louisville Gas & Electric Co.* v. *Coleman,* 277 U. S. 32, 37-39, 48 S. Ct. 423, 72 L. Ed. 770.

It is further contended that this statutory provision is not only not comparable to statutes of limitations, as suggested by the Court of Appeals (R. 12), but that any comparison therewith serves to accentuate the material difference. Such statutes are for repose against *stale* claims rendered difficult of proof or defense *by passage of time.* Hence with respect to statutes of limitations, as to the defense of laches, it is time which has the direct, causative effect to alter circumstances; whereas time in the statute here involved has no effect at all to change into a capital asset property which was something else earlier.

The Court of Appeals suggests that the purpose of the statute is to distinguish between investment and speculation. This Court in *Helvering* v. *New York Trust Co.*, 292 U. S. 455, 466, 54 S. Ct. 806, 809, 78 L. Ed. 1361, shows that this is a misapprehension; that, on the contrary, a holding period requirement in such cases was originally used by Congress in order to promote realization of gains and thereby to increase revenue. That purpose, however, fails altogether in the case of a statute such as here in question, because therein Congress failed to impose any tax to harvest the results of the holding period device. So far as its opinion shows (R. 11-12) this radical difference between federal income tax laws and the income tax law here involved was overlooked by the Court of Appeals.

The statute here involved, if the view of the Court of Appeals is correct, would treat as speculative even government bonds until they had been held longer than two years; it would treat as speculative involuntary sales of property acquired in actual fact without thought other than investment by decedents' estates, by other fiduciaries, or by insolvency, and in many such circumstances.

Even if it be considered that there may be some adventitious tendency of this two year holding provision to distinguish investment from speculation, the undiscriminating force of the statute is as objectionable as was the statutory provision held invalid by this Court in *Heiner* v. *Donnan*,

supra. Just as under the statute there held invalid, it might well be the destiny of a transferror of property, made without thought of death, to die before two years had elapsed; so under the statute in this case it might as well be the destiny of a holder of property, acquired without thought of speculation, to be compelled to part therewith before two years had elapsed.

CONCLUSION.

It is believed that the Court of Appeals has herein decided a question of substance relating to the application of the Constitution of the United States to an Act of Congress, which is one of material consequence to the revenues of the District of Columbia and to the taxpayers thereof, and that in so doing the court has not given proper effect to opinions of this Court, in particular to its opinion in *Heiner* v. *Donnan, supra*.

Wherefore it is respectfully urged that the writ be granted.

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BRIEF IN SUPPORT OF PETITION FOR CERTIORARI.

The Opinion of the Court of Appeals is not yet reported but appears in the record (R. 11-12). The Opinion of the Board of Tax Appeals is in the record (R. 5-7).

Statement of grounds of jurisdiction, statement of the case, and statement of the question involved and of reasons urged for allowance of the writ, are set forth in the petition therefor.

Specification of Error.

It was error for the Court of Appeals to hold reasonable and, therefore, valid the provision of sec. 6(a) of the income tax law of the District of Columbia (53 Stat. 1091, sec. 47-1506(a) D. C. Code 1940), which, in defining capital assets, requires that the same be held for more than two years.

Argument.

I.

The requirement that property be held for more than two years, in order to be recognized as a capital asset and as such immune from tax on sale, is, it is contended, arbitrary, unreasonable and contrary to fact, and therefore invalid under the Fifth Amendment of the Constitution as applied by this Court in numerous decisions, including particularly *Heiner* v. *Donnan*, 285 U. S. 312, 52 S. Ct. 358, 76 L. Ed. 772; cf. *Louisville Gas & Electric Co.* v. *Coleman*, 277 U. S. 32, 37-39, 48 S. Ct. 423, 72 L. Ed. 770.

The case first cited above holds that a statutory irrebuttable presumption that a gift made within two years of death is in contemplation thereof, and subject to federal estate tax in consequence, is invalid as unreasonable, considering that the fact may well be otherwise. It appears to be considered that since one may not be able to control the hour of his death, he may happen to die within two years of such gift, although death was in fact in no sense the activating motive of the transfer sought to be taxed. Equally is it true that, under the form of the statute in the present case, the acquirer of capital assets may be compelled to part therewith through circumstances beyond his control within two years of acquisition.

Louisville Gas & Electric Co. v. *Coleman*, *supra*, appears particularly apt to the statutory requirement in this case, although there a statute of a state was in question. The decision makes plain that a distinction or discrimination good for one purpose may be bad for another; that the period of time that an obligation runs might be used to proportion the amount of tax upon the obligation, but that such a time factor is not of sufficient relevance or materiality to support the radical difference between imposing some tax or none at all.

The Court of Appeals in its opinion herein says: "The apparent purpose of Congress was to distinguish, for tax purposes, between investment and speculation", and quotes

similar language from *Davis* v. *United States,* 87 Fed. 2d 323, 325, C. C. A. 2d. (R. 12.) The language quoted and relied upon from that case appears to be obiter dicta, because the question therein was as to allowance of a tax deduction which is a matter of grace, and to which no one can be entitled as of right in a Constitutional sense, since Congress might impose an income tax if it saw fit without deduction at all. Moreover, that case concerned the federal income tax which, as set forth in the petition herewith, does not attach the consequence of no tax at all to the holding period requirement it makes, as does the statute presently involved, but uses its requirement merely to affect the amount or proportion of the tax imposed.

However, even if apt to this case, the statement of the court in *Davis* v. *United States,* and the echoing statement of the Court of Appeals above quoted, appear erroneous and to rest upon misapprehension. It is plain that Congress did not originally adopt a holding period with respect to capital gains with the thought of attempting thereby to distinguish between investment and speculation. The purpose was otherwise. It was in order to increase the productivity of the income tax law. Prior to 1921 income tax statutes made no distinction with respect to gain from sales of capital assets and income generally. By 1920 it was found that the attempt theretofore to tax capital gains at full rates in all circumstances resulted in injury to the revenue in two ways: first, gains were not realized by sale so there was nothing to tax, and secondly, losses were taken in order to offset them against other income, so taxes were reduced. Accordingly it was that with the Revenue Act of 1921, and ever since, Congress has offered a more favorable rate if the property sold had been retained for an appreciable time.

This Court, in *Helvering* v. *New York Trust Co.,* 292 U. S. 455, 466, 54 S. Ct. 806, 809, 78 L. Ed. 1361, reviews the history of the provision and quotes at length from a report of the Ways and Means Committee made at the time of the original adoption of the distinction as to capital assets, in the Revenue Act of 1921, a portion of which reads:

> "The sale of * * * capital assets is now seriously retarded by the fact that gains and profits earned over a series of years are under the present law taxed as a lump sum (and the amount of surtax greatly enhanced thereby) in the year in which the profit is realized. Many such sales, with their possible profit taking and consequent increase of the tax revenue, have been blocked by this feature of the present law. * * * It is believed that the passage of this provision" (imposing a lower rate if property is held for a prescribed period) "would materially increase the revenue, not only because it would stimulate profit taking transactions but because the limitation of 15 per cent is also applied to capital losses. Under present conditions there are likely to be more losses than gains."

It is common knowledge that few investments can be held with confidence for any extended period of time, that no investment may be depended upon to maintain its character as such without constant attention by the holder and danger of change for the worse. It is equally well known that normally also interest or dividend provisions—a feature of investments—require payments for periods much shorter than two years.

Fiduciaries, forbidden to speculate, are not infrequently faced with the necessity of disposing of investments which they may have held for only a short time, because they are not adapted to the terms of their trusts, or because market changes have rendered them imprudent. The tax under this statute applies to disposal of holdings which have been undeniably acquired for investment purposes, whether caused by settlement of estates, by fiduciary management, by insolvency, by unavoidable cash need of the owner, and many other involuntary causes.

The length of time that property is retained appears to have little if any force to indicate whether it was originally acquired for investment or for speculation. Investments may be, and they often are, changed at short intervals, from a variety of causes; speculations may be, and they often are, adhered to through many years of hope deferred. It is

the character of the property or enterprise itself, its demonstrated earning power or income yield, or the reverse, its present worth or potential value—it is these and other factors which tend to show the underlying purpose or motive of acquisition.

Since Congress copied the provision with respect to holding capital assets in the District of Columbia income tax law from the federal income tax acts, in spite of the totally different tax effect of its use, there seems no possible suggestion of a policy to make some new and original distinction thereby. If Congress had thereby intended some police regulation, at the expense of the income tax revenue of the District, with respect to speculation, it could easily have said so and adopted some test germane to the purpose.

The question arises, then, why did Congress introduce a holding period with respect to sale of capital assets in the first place, when it sought to increase revenue yield by different treatment of such sales in the Revenue Act of 1921? Why, in other words, did it make a distinction between sales of such assets when held for a longer or shorter period? The quotation from the Opinion of this Court in *Helvering* v. *New York Trust Company,* above, shows that the basic purpose was solely to increase the revenue yield, and that a subordinate rationale was the fact that such gains ordinarily represent increment over a period of time. May it not be that a holding period, with a lower rate after it, was used because it was considered that for a relatively short period after acquisition sales made would be those in the main which were unavoidable, hence that revenue would not suffer but benefit by taxing at full rates, but that, in order to obtain realization of gains substantial in amount and which could be avoided, some inducement by a more favorable rate must be extended?

Such consideration as above suggested would apply, with effect and with marked benefit to the revenue yield, in an enactment which did in fact tax all gains at some rate, but it is inept, destructive of revenue, without reason and discriminatory without basis, when carried, as it is, into an en-

actment which fails to impose any tax at all to reap the results of the inducement, such as the statute here involved.

Thus there is left no rational basis for the discrimination of the District of Columbia act, and the consequence is an invalid discrimination against taxpayers such as petitioners.

II.

Since the Court of Appeals in its opinion (R. 11-12) goes to the merits of petitioners' contention, it may be unnecessary here to refer to the basis of the decision of the Board of Tax Appeals as disclosed by its opinion (R. 5-7). Briefly, the Board's theory was that petitioners could not benefit even if their contention on the merits were correct, on the theory that even if sec. 6(a) of the Act were stricken down, they would still be taxable on their gains by sec. 6(b) and other provisions of the statute. In addition to the fact that the Court of Appeals reached the question of constitutionality, and hence can have found no merit to that theory of the Board, it may be enough for present purposes to list briefly some of the reasons why it is untenable:

1. Petitioners do not contend that sec. 6(a) is invalid in toto, only that the two year holding provision thereof is invalid, and that such provision is separable, namely *"for more than two years"*. If that provision only be stricken down, there would then be no tax under sec. 6(a). The definition of capital assets would then approximate that of sec. 117 of the Internal Revenue Code.

2. If the two year holding provision is deemed inseparable from the rest of the definition of sec. 6(a) and that subsection must fall in its entirety, still there would be no tax here under sec. 6(b), which so far as material here reads: "Gains * * * from the sale or exchange of property *other than a capital asset*" (italics added) are to be taxed, leaving the term "capital asset" without statutory definition. Since words in taxing acts are to be taken in their ordinary meanings (*Helvering* v. *William Flaccus Oak Leather Co.,* 313

U. S. 247, 249, 61 S. Ct. 878, 880, 85 L. Ed. 1310), and since securities are in fact manifestly capital assets, no tax would be imposed here.

3. If the provision here challenged is invalid, the remedy is to remit the tax at suit of the taxpayer discriminated against. The authorities are numerous and unanimous that in such case the tax, not the exemption, falls: *Louisville Gas & Electric Co.* v. *Coleman, supra; Smith* v. *Cahoon,* 283 U. S. 553, 51 S. Ct. 582, 75 L. Ed. 1264; *Royster Guano Co.* v. *Virginia,* 253 U. S. 412, 40 S. Ct. 560, 64 L. Ed. 989; *Colgate* v. *Harvey,* 296 U. S. 404, 56 S. Ct. 252, 80 L. Ed. 299, 102 A. L. R. 54.

Conclusion.

Wherefore it is respectfully submitted that the petition for writ of certiorari herein should be granted.

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